

GHF, INC., d/b/a MYSTIK FOOD MART §
2403 CHASE LAKE PARKWAY
BIRMINGHAM, AL 35244, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. S. 09-1221

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed GHF, Inc., d/b/a Mystik Food Mart (“Taxpayer”) for State and local sales tax for April 2006 through January 2009. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on May 27, 2010. The Taxpayer’s owners, Murbarak and Faimeena Somani, attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer operated a convenience store on Highway 280 in Talladega County, Alabama during the period in issue. The owners managed the business with the help of a relative.

The Department audited the Taxpayer for sales tax and requested the Taxpayer’s sales tax-related records. The Taxpayer provided some cash register z-tapes, sales journals, income tax returns, purchase invoices, and bank records.

The Department examiner reviewed the bank statements and determined that deposits from cash sales were minimal. He also found that monthly deposits consistently exceeded the store’s reported monthly sales.

The cash register z-tapes provided by the Taxpayer were inconclusive and incomplete. Some were illegible, and the monthly sales totals on the tapes did not match

the totals in the Taxpayer's sales journal or on its monthly sales tax returns.

The examiner obtained purchase information from the Taxpayer's vendors, which showed that the invoices provided by the Taxpayer were incomplete. The Taxpayer's total monthly wholesale purchases, as shown by the vendor invoices, also greatly exceeded its reported monthly retail sales. Specifically, the Taxpayer's monthly wholesale purchases averaged approximately \$40,000, whereas its monthly reported retail sales averaged approximately \$15,000.

Because the Taxpayer's records were inaccurate and/or incomplete, the Department examiner computed the Taxpayer's liability using a purchase mark-up audit. He used the vendor invoices to determine the Taxpayer's total purchases. He then computed the Taxpayer's total retail sales by applying the standard 35 percent mark-up used by the IRS for convenience stores, i.e., small businesses that sell food, beverages, and gasoline. He then applied the 4 percent State sales tax rate to total sales to determine the total tax due. He allowed a credit for sales tax previously paid by the Taxpayer to arrive at the additional tax due. The Department also added the 50 percent fraud penalty levied at Code of Ala. 1975, §40-2A-11(d). The examiner's audit report explained the rationale for the fraud penalty, as follows:

The Taxpayer grossly underreported sales evidenced by the fact that purchases, including purchase detail obtained from known vendors exceeded reported sales. Reported taxable sales averaged \$15,000 and taxable purchases averaged \$40,000 each month during the audit period. It should be noted that the taxpayer provided incomplete records during the audit period. Therefore, a fifty percent fraud penalty was applied to the liability.

Dept. Ex. 1 at 4.

The Taxpayer's owners contend that some of the merchandise they purchased was used to stock another store. They failed, however, to identify the other store or the amount of merchandise presumably transferred to that store.

The owners concede that they failed to collect sales tax on phone cards. They argue, however, that the overall 35 percent mark-up used by the Department is excessive, and that a 19 – 24 percent mark-up is more realistic. Finally, they contend that the Department assessed non-taxable items such as newspapers, and that delivery charges were included in the vendor invoices, and thus improperly marked-up by the Department.

All taxpayers subject to sales tax are required to keep complete and accurate records from which the Department can accurately determine the taxpayer's correct liability. Code of Ala. 1975, §§40-2A-7(a)(1) and 40-23-9; *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982). If a taxpayer fails to keep adequate records, the Department can use any reasonable method to compute the taxpayer's liability. The taxpayer cannot later complain that the liability so computed by the Department is inexact. *Jones v. C.I.R.*, 903 F.3d 1301 (10th Cir. 1990).

The Department's use of a purchase mark-up audit is a commonly used and accepted method of computing a taxpayer's sales tax liability in the absence of adequate records. See generally, *Alsede v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04); *Arnold v. State of Alabama*, S. 03-1098 (Admin. Law Div. 7/27/04); *Moseley's One Stop, Inc. v. State of Alabama*, S. 03-316 (Admin. Law Div. 7/28/03); *Pelican Pub & Raw Bar, LLC v. State of Alabama*, S. 00-286 (Admin. Law Div. 12/15/00); *Joey C. Moore v. State of Alabama*, S. 99-126 (Admin. Law Div. 8/19/99); *Robert Earl Lee v. State of Alabama*, S. 98-179 (Admin. Law Div. 6/28/99); *Red Brahma Club, Inc. v. State of Alabama*, S. 92-171

(Admin. Law Div. 4/7/95); and *Wrangler Lounge v. State of Alabama*, S. 85-171 (Admin. Law Div. 7/16/86).

In this case, the Department examiner determined that the Taxpayer's records were insufficient because its cash register tapes were incomplete and did not reflect the Taxpayer's reported sales. He also concluded that the Taxpayer had not correctly reported its monthly sales because its monthly purchases, without mark-up, greatly exceeded its reported monthly sales. The examiner thus correctly computed the Taxpayer's liability using the purchase mark-up audit.

As indicated, the owners claim that the Department audit is flawed for several reasons. Specifically, they claim that their newspaper sales should not be taxed because none of their competitors charge sales tax on newspapers. I disagree. Newspapers are tangible personal property subject to sales tax. I also disagree that delivery charges should be deleted from the vendor invoices before mark-up because the delivery charges were a part of the Taxpayer's cost of goods sold.

The owners also contend that the 35 percent mark-up is excessive. They claim that a 19 – 24 percent average mark-up is more accurate. They failed, however, to present any evidence supporting that claim. To the contrary, the Department examiner performed a spot check at the business during the audit which showed a 74 percent mark-up. The Department's Audit Report, Dept. Ex. 1, reads in part as follows, at 5:

An analysis was conducted to calculate the average purchase markup on merchandise based on the most recent invoices provided. The invoice price of the merchandise was compared to the listed store price used to calculate the average markup. The Examiner calculated the overall average purchase markup to the seventy-four (1.74) percent.

As discussed, all taxpayers subject to sales tax are required to keep contemporaneous sales records from which the Department can accurately compute and verify the taxpayer's liability. "The State is not required to rely on verbal assertions of the taxpayer in determining the correctness of the tax return, but records should be available disclosing the business transacted. Where there are no proper entries on the records . . . , the taxpayer must suffer the penalty of noncompliance and pay on the sales not so accurately recorded as exempt." *State v. Ludlam*, 384 So.2d 1089, 1091 (Ala. Civ. App.) cert. denied, 384 So.2d 1094 (Ala. 1980), quoting *State v. T. R. Miller Mill Co.*, 130 So.2d 185 (1961). Consequently, because the Taxpayer failed to maintain sufficient records from which its correct liability could be determined or verified, the Department's reasonable computations per the mark-up audit must be affirmed.

The remaining and more difficult issue is whether the fraud penalty was correctly applied. The owners testified openly at the May 27 hearing. Unfortunately, they did not adequately explain how they could purchase approximately \$40,000 in merchandise in each month of the 33 month audit period, and yet only report on average approximately \$15,000 in taxable retail sales in each month.¹ Some of the merchandise purchased in the months after the store opened could have gone to build inventory, but the business consistently purchased approximately \$40,000 in goods in each month throughout the audit period, which indicates that it was also selling that volume of goods. And even if the business had applied an average 19 - 24 percent mark-up, as the owners claim, the

¹ The Department examiner prepared a chart which illustrates the discrepancy between the large amount of merchandise purchased by the Taxpayer and the relatively small amount of sales actually reported during the audit period. That chart, Department Ex. 2, is attached to and made a part of this Final Order.

monthly retail sales would have averaged at least \$48,000, or more than triple what the Taxpayer actually reported on average.

There may be a reasonable explanation why the Taxpayer's monthly purchases greatly exceeded its reported monthly sales, i.e., the owners may have, as they claim, taken some of the goods to another store, there may have been considerable theft, etc., but no such evidence was submitted at the May 27 hearing. The Taxpayer also submitted various exhibits with its appeal letter. Exhibit B identified purchases of \$14,057.64 that the Taxpayer claims were improperly included in the audit. Again, however, there was no evidence verifying that claim. Consequently, based on the evidence showing a lack of records and the large discrepancy between the goods purchased by the Taxpayer and its reported sales, I must conclude that the Taxpayer intentionally underreported its sales during the audit period. The fraud penalty was thus correctly applied. If the owners have evidence explaining the lack of records, and especially the large discrepancy in the amount of merchandise purchased in each month and the monthly reported sales, they may appeal to circuit court and present such evidence on appeal.

The final assessment is affirmed. Judgment is entered against the Taxpayer for State sales tax, penalties, and interest of \$51,852.78, and local sales tax, penalties, and interest of \$51,852.12.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered August 10, 2010.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

attachment

cc: J. Wade Hope, Esq.
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